

Accounting Standards Advisory Forum meeting

Conceptual Framework

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Profit or Loss/OCI and Measurement

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This paper has been prepared by the ASBJ for the December 2013 ASAF meeting.

Introduction

1. On 18 July 2013, the IASB published for public comment a Discussion Paper, *A Review of the Conceptual Framework for Financial Reporting* (hereinafter referred to as “the DP”). The ASBJ highly appreciates the IASB’s efforts on the Conceptual Framework project.
2. In the DP, Section 6 discusses measurement and Section 8 discusses the presentation of profit or loss and other comprehensive income (hereinafter referred to as “OCI”). In this paper, the ASBJ focuses on analysing the relationship between Section 6 and Section 8 of the DP. In many respects the ASBJ shares common views with the proposals outlined in the DP. However, the ASBJ thinks that there are several areas where the DP could be improved.
3. In order to contribute to the development of the revised Conceptual Framework, the ASBJ discusses the following topics in this paper:

Chapter 1: Definitions of comprehensive income, profit or loss and OCI

Chapter 2: Nature of profit or loss

Chapter 3: Using two measurement bases for the same item

Chapter 4: Recycling

Supplementary considerations:

- Additional commentary on how to determine the measurement bases
- Analysis of OCI items under existing IFRSs

Executive Summary:

Chapter 1: Definitions of comprehensive income, profit or loss and OCI

- The ASBJ suggests defining comprehensive income, profit or loss and OCI as separate elements of financial statements in the following manner:
 - (a) **Comprehensive income** is the change in net assets during a period except those changes resulting from transactions with owners in their capacity as owners, whereby the recognised assets and liabilities comprising the net assets are measured using measurement bases that are relevant from the perspective of reporting an entity's *financial position*.
 - (b) **Profit or loss** is the change in net assets during a period except those changes resulting from transactions with owners in their capacity as owners, whereby the recognised assets and liabilities comprising the net assets are measured using measurement bases that are relevant from the perspective of reporting an entity's *financial performance*.
 - (c) **OCI** is “the linkage factor” that is used when the measurements that are relevant from the perspective of reporting an entity's *financial position* differ from the measurements that are relevant from the perspective of reporting an entity's *financial performance*.
- The ASBJ's view is that the difference between comprehensive income and profit or loss is essentially a timing difference and conceptually the accumulated amount of profit or loss for all accounting periods should equal the accumulated amount of comprehensive income for all accounting periods.

Chapter 2: Nature of profit or loss

- The ASBJ suggests describing the nature of profit or loss as follows:

Profit or loss represents an all-inclusive measure of irreversible outcomes of an entity's business activities in a certain period.

 - ✓ The phrase “irreversible outcomes of an entity's business activities” means that the uncertainty regarding the outcomes of an entity's business activities is reduced to the point where the outcomes are irreversible or deemed irreversible.

Executive Summary (continued):

Chapter 3: Using two measurement bases for the same item

- The ASBJ thinks that two different measurement bases should be used for the same item and thus OCI should be used as the linkage factor, when:
 - (a) it is relevant from the perspective of reporting an entity's *financial position* to remeasure assets and liabilities that are exposed to certain risks by using the information updated at the reporting date; but
 - (b) such remeasurements are not relevant from the perspective of reporting an entity's *financial performance*.
- There may be cases where using measurements that reflect the risk factors at the reporting date are relevant from the perspective of reporting an entity's *financial position*, but the effects of these remeasurements are not relevant from the perspective of reporting an entity's *financial performance* when the uncertainty regarding the outcomes of an entity's business activities has not been reduced to the point where the outcomes are irreversible or deemed irreversible. Such situations often occur when the time horizon is long.

Chapter 4: Recycling

- The ASBJ's view is that recycling would be achieved automatically as a mechanism and, therefore, non-recycling items would not exist.
- The ASBJ thinks that recycling occurs when:
 - (a) related assets or liabilities are derecognised;
 - (b) impairment losses are recognised for related assets; or
 - (c) a natural reverse occurs with the passage of time.

Chapter 1: Definitions of comprehensive income, profit or loss and OCI

4. Section 2 of the DP discusses the elements of financial statements. The DP proposes defining asset, liability, equity, income and expense as elements of financial statements, while leaving comprehensive income, profit or loss and OCI undefined.
5. However, the ASBJ suggests defining comprehensive income and profit or loss as separate elements of financial statements in the following manner:
 - (a) **Comprehensive income** is the change in net assets during a period except those changes resulting from transactions with owners in their capacity as owners, whereby the recognised assets and liabilities comprising the net assets are measured using measurement bases that are relevant from the perspective of reporting an entity's *financial position*.
 - (b) **Profit or loss** is the change in net assets during a period except those changes resulting from transactions with owners in their capacity as owners, whereby the recognised assets and liabilities comprising the net assets are measured using measurement bases that are relevant from the perspective of reporting an entity's *financial performance*.
6. The definitions in the preceding paragraph are suggested under the premise that two measurements would be used for certain assets and liabilities, although a single measurement would be used for most assets and liabilities. Measurements of assets and liabilities that are relevant from the perspective of reporting an entity's *financial position* (and are used to determine comprehensive income) are presented in the statement of financial position. Measurements of assets and liabilities that are relevant from the perspective of reporting an entity's *financial performance* (and are used to determine profit or loss) can be different from the measurements presented in the statement of

financial position. In Chapter 3 of this paper, the ASBJ explores the situations where two different measurement bases should be used for the same item.

7. When comprehensive income is different from profit or loss, OCI is used as “the linkage factor.” The ASBJ suggests that OCI be defined as an element of financial statements in the following manner:

OCI is “the linkage factor” that is used when the measurements that are relevant from the perspective of reporting an entity’s *financial position* differ from the measurements that are relevant from the perspective of reporting an entity’s *financial performance*.

8. In the following paragraphs, the ASBJ considers (a) the elements of financial statements (paragraphs 9 through 12 of this paper), and (b) the use of two different measurement bases (paragraphs 13 through 15 of this paper).
9. The ASBJ thinks that asset, liability, equity, profit or loss, comprehensive income and OCI should all be treated as elements of financial statements¹. The ASBJ thinks that the elements of financial statements should be determined in light of the objective of financial reporting. In particular, the ASBJ thinks that the following paragraphs in the IASB’s Conceptual Framework should be considered when elements of financial statement are determined:
 - (a) General purpose financial reports provide information about the financial position of a reporting entity, which is information about the entity’s economic resources and the claims against the reporting entity. (OB12)
 - (b) Changes in a reporting entity’s economic resources and claims result from that entity’s financial performance and from other events or transactions such as issuing debt or equity instruments. (OB15)

¹ The ASBJ thinks that income and expense may not necessarily need to be treated as elements of financial statements if profit or loss, comprehensive income and OCI are elements and presented in the financial statements.

(c) Information about a reporting entity's financial performance helps users to understand the return that the entity has produced on its economic resources.

(OB16)

10. Some elements of financial statements should be determined directly in light of the objective of financial reporting while other elements should be determined considering the interrelation between the elements of financial statements (hereinafter referred to as "articulation").
11. First, the ASBJ thinks that asset, liability, equity and profit or loss should be treated as elements of financial statements that are derived directly from the objective of financial reporting. The ASBJ thinks that the totals of assets, liabilities and equity provide the most relevant information from the perspective of reporting an entity's *financial position* and thus should be treated as elements of financial statements. In addition, the ASBJ thinks that profit or loss provides the most relevant information to report an entity's *financial performance*².
12. Secondly, the ASBJ thinks that comprehensive income and OCI should be treated as elements of financial statements in order to represent the interrelation between the elements of financial statements. When equity is treated as an element of financial statements, it is necessary that comprehensive income is also treated as an element of financial statements due to articulation³. OCI is also needed as an element of financial statements due to articulation⁴ when profit or loss and comprehensive income are treated as elements of financial statements.

² The reason why profit or loss provides more relevant information than comprehensive income is described in paragraph 28 of this paper.

³ Investments by and distributions to owners also should be treated as elements of financial statements. The interrelation between the elements of financial statements can be illustrated as follows:

$$\text{Equity at beginning of the period} + \text{Comprehensive income} + \text{Investments by and distributions to owners} = \text{Equity at end of the period.}$$

⁴ The interrelation between the elements of financial statements can be illustrated as follows:
 $\text{Comprehensive income} - \text{Profit or loss} = \text{OCI}$

13. The ASBJ thinks that the view that two different measurement bases can be used for certain assets and liabilities is consistent with the DP. Specifically, the DP states the following:
- (a) Paragraph 6.15 of the DP states that measurement affects both the statement of financial position and the statement(s) of profit or loss and OCI;
 - (b) Paragraph 6.76 of the DP states that one possible way of dealing with uncertainty about how an asset will contribute to future cash flows would be to provide more than one measure of the asset and this could be done by using one measure in the statement of financial position and using a different measure to determine the amounts recognised in profit or loss; and
 - (c) Paragraph 8.55 of the DP states that the IASB may occasionally decide that an asset or a liability should be remeasured, but that information in profit or loss should be based on a measurement that differs from the one used in the statement of financial position provided both measurements are meaningful, understandable and clearly describable.
14. The DP classifies OCI items into three categories, namely “bridging items,” “mismatched remeasurements” and “transitory remeasurements.” However, the ASBJ suggests a single category, namely “the linkage factor,” based on the definition suggested in paragraph 7 of this paper.
15. Some may argue that comprehensive income can be determined systematically based on the changes in net assets but that profit or loss cannot. However, the ASBJ takes a different view that the difference between comprehensive income and profit or loss arises solely from the differences in the measurement bases used for certain assets and liabilities, and that both comprehensive income and profit or loss are systematically determined based on the changes in net assets. Accordingly, the difference between comprehensive income and profit or loss is essentially a timing difference and conceptually the accumulated amount of

profit or loss for all accounting periods should equal the accumulated amount of comprehensive income for all accounting periods.

Chapter 2: Nature of profit or loss

16. In paragraph 5 of this paper, the ASBJ suggested defining profit or loss in the following manner:

Profit or loss is the change in net assets during a period except those changes resulting from transactions with owners in their capacity as owners, whereby the recognised assets and liabilities comprising the net assets are measured using measurement bases that are relevant from the perspective of reporting an entity's *financial performance*.

17. The definition suggested in the preceding paragraph explains the mechanism used to determine profit or loss, while leaving the nature of profit or loss unexplained. In this Chapter, the ASBJ discusses the nature of profit or loss.

18. The ASBJ suggests describing the nature of profit or loss in the following manner:

Profit or loss represents an all-inclusive measure of irreversible outcomes of an entity's business activities in a certain period.

19. The ASBJ thinks that the key concepts in describing the nature of profit or loss are “irreversible outcomes of an entity's business activities” and “all-inclusive.” In the following paragraphs, the ASBJ discusses these two key concepts in more detail.

Irreversible outcomes of an entity's business activities

20. The phrase “irreversible outcomes of an entity's business activities” means that the uncertainty regarding the outcomes of an entity's business activities is reduced to the point where the outcomes are irreversible or deemed irreversible.

21. Users of financial statements need information to help them assess the prospects for future net cash inflows to an entity⁵. Information about a reporting entity's past financial performance and how its management discharged its responsibilities is usually helpful in predicting the entity's future returns on its economic resources⁶.
22. The ASBJ thinks that profit or loss should represent the "irreversible outcomes of an entity's business activities" that reflect an entity's past financial performance in order to help users assess the prospects for future net cash inflows to the entity. It is important to report on "irreversible outcomes of an entity's business activities" because information is not sufficiently robust if profit or loss includes the outcomes of an entity's business activities whose uncertainty has not been reduced to the point where the outcomes are irreversible or deemed irreversible and such information may mislead users in assessing the prospects for future net cash inflows to the entity.
23. When an entity enters into business activities, the entity has an expectation that certain future cash flows will be generated. However, the outcomes of an entity's business activities normally are initially uncertain. The ASBJ thinks that profit or loss should be recognised when the uncertainty regarding the outcomes of an entity's business activities is reduced to the point where the outcomes are irreversible or deemed irreversible⁷.
24. For example, in the case of debt securities, an entity could generate cash flows equivalent to the current market price of the asset if it sold the assets at the reporting date, but the entity may not be sure whether it will hold them for

⁵ Paragraph OB3 of the IASB's Conceptual Framework.

⁶ Paragraph OB16 of the IASB's Conceptual Framework.

⁷ For example, profit or loss should be recognised when an asset is sold because the uncertainty regarding the outcomes of an entity's business activities is totally extinguished through the transfer of control. In addition, the ASBJ thinks that recognising expenses can be explained using this concept. For example, depreciation of property, plant and equipment should be recognised in profit or loss because the uncertainty regarding the outcomes of an entity's business activities is reduced to the point where the outcomes are deemed irreversible to the extent that the asset's economic benefits have been consumed.

collection according to terms or sell them. In this case, the uncertainty regarding how the asset contributes to future cash flows (that is, either holding it for collection according to terms or selling it) has not been reduced to the point where the outcomes are irreversible or deemed irreversible. Accordingly, gains or losses from remeasurements that reflect the changes in the current market price should not be recognised in profit or loss. On the other hand, when the assets are sold, the uncertainty is extinguished and thus profit or loss should be recognised.

25. The phrase “irreversible outcomes of an entity’s business activities” does not suggest cash-based accounting. What would be considered as the outcomes of an entity’s business activities can vary depending on the initial expectations when the entity enters into business activities.
26. For example, in cases where investments are made for trading purposes, the outcomes of an entity’s business activities are deemed irreversible because it is presumed that the entity willingly accepted the uncertainty regarding the fluctuations in the current market price and thus the changes between cost and current market price represent the outcomes of the business activities in light of the purpose of such investments. Accordingly, the changes in the current market price should be recognised in profit or loss as they occur.
27. In addition, the ASBJ thinks that the robustness of profit or loss is also necessary from the perspective of stewardship⁸. When an entity provides information regarding how its management discharged its responsibilities, the ASBJ thinks that it is important to report profit or loss in instances where the uncertainty regarding the outcomes of an entity’s business activities is reduced to the point where the outcomes are irreversible or deemed irreversible.

⁸ Paragraph OB4 of the IASB’s Conceptual Framework.

28. As discussed in Chapter 1 of this paper, the ASBJ thinks that both comprehensive income and profit or loss should be treated as elements of financial statements. Comprehensive income is an important element required to understand the relationships between primary financial statements, but comprehensive income may not be sufficiently meaningful from the perspective of reporting an entity's *financial performance* because comprehensive income, as suggested in paragraph 5 of this paper, would be determined based on the measurements which are relevant from the perspective of reporting an entity's *financial position*. Furthermore, when measuring certain items to determine comprehensive income, the uncertainty regarding the outcomes of an entity's business activities may not have been reduced to the point where the outcomes are irreversible or deemed irreversible because the measurement bases are determined from the perspective of reporting the entity's *financial position*. On the other hand, profit or loss provides information about an entity's past financial performance through the selection of appropriate measurement bases. Accordingly, the ASBJ thinks that profit or loss, apart from comprehensive income, is necessary.

All-inclusive

29. The phrase “all-inclusive” suggests that all transactions and events that occur in a certain period are taken into consideration.
30. As described in paragraph 15 of this paper, the ASBJ thinks that the difference between comprehensive income and profit or loss is essentially a timing difference and conceptually the accumulated amount of profit or loss for all accounting periods should equal the accumulated amount of comprehensive income for all accounting periods.
31. In addition, the ASBJ thinks that the accumulated amount of profit or loss for all accounting periods should equal the accumulated amount of net cash flows,

other than net cash flows resulting from transactions with owners in their capacity as owners, for all accounting periods. When assessing the value of an entity, users of financial statements normally depend on flow information to assess the prospects for future net cash inflows to that entity⁹. Users of financial statement have suggested that profit or loss is one of the most useful indicators that they can refer to. However, these users may find it difficult to refer to profit or loss if the integrity of profit or loss information is not supported by the consistency with cash flows.

32. The concept of “all-inclusive” suggests that both expected and unexpected outcomes are explicitly included in profit or loss. In the course of business activities both expected outcomes and unexpected outcomes, or windfalls which had not been initially expected, can occur. By requiring the concept of “all-inclusive,” the so-called “windfall” will be included in profit or loss.
33. In addition, the ASBJ thinks that the concept of “all-inclusive” is consistent with the stewardship notion. From the perspective of stewardship, financial statements should be all-inclusive and any profit or loss should be disclosed even if certain transactions or events are considered non-recurring because this information has implications for assessing management competence.
34. Profit or loss is different from operating income because it considers all transactions and events that occur in a certain period. The concept of “all-inclusive” ensures the integrity of profit or loss as the primary source of information about the return an entity has generated on its economic resources. The ASBJ thinks that operating income is useful in predicting future sustainable income. However, the ASBJ thinks that operating income is useful only as long as it is disclosed as a subset of profit or loss which in-turn is consistent with cash flows.

⁹ Stock information can be also useful in assessing future net cash inflows to an entity. In particular, this is applicable to assets that generate cash flows by themselves.

Chapter 3: Using two measurement bases for the same item

35. The discussion in Chapter 1 of this paper presumes that two different measurement bases can be used for certain assets and liabilities, although a single measurement basis would be used for most assets and liabilities. In this Chapter, the ASBJ discusses when two different measurement bases should be used for the same item¹⁰. In addition, further analysis, separately discussing assets and liabilities, is provided later in this paper.
36. The ASBJ thinks that two different measurement bases should be used for the same item and thus OCI should be used as “the linkage factor,” when:
- (a) it is relevant from the perspective of reporting an entity’s *financial position* to remeasure assets and liabilities that are exposed to certain risks by using the information updated at the reporting date; but
 - (b) such remeasurements are not relevant from the perspective of reporting an entity’s *financial performance*.
37. Assets and liabilities are exposed to various risks, including market risk and credit risk. Market risk includes the effects of changes in macroeconomic factors, including interest rates, foreign exchange rates and stock prices. Appendix A of this paper illustrates the relationships between existing OCI items and risk exposures.
38. Approaches to reflect such risk exposures may include:
- (a) measuring assets or liabilities by using current market prices;

¹⁰ Consistent with the proposals in the DP, this paper groups measurements into three categories:

- (a) cost-based measurement;
- (b) current market price; and
- (c) cash-flow-based measurement.

Fair value is included in current market price under this categorisation.

- (b) measuring assets or liabilities by using other cash-flow-based measurements where inputs are updated at the reporting date; and
 - (c) disclosing risk exposure information in the notes to financial statements.
39. The ASBJ thinks that oftentimes approaches (a) and (b) described in the preceding paragraph are relevant from the perspective of reporting an entity's *financial position*. This is because cost-based measurements or other cash-flow-based measurements based on information available at initial recognition are sometimes “stale” when users of the statement of financial position assess the amount, timing and uncertainty of future net cash inflows to the entity. Accordingly, there are cases where using measurements that reflect risk exposures at the reporting date can be more relevant.
40. However, the effects of remeasurements are not relevant from the perspective of reporting an entity's *financial performance* when the uncertainty regarding the outcomes of an entity's business activities has not been reduced to the point where the outcomes are irreversible or deemed irreversible. Such situations often occur when the time horizon is long.
41. The effects of remeasurements are not relevant from the perspective of reporting an entity's *financial performance* because the effects of remeasurements that reflect the risk factors (for example, market risks including interest rate risk and stock price risk) at the reporting date may not immediately suggest ultimate cash flows or such factors could significantly fluctuate before the ultimate cash flows occur. In these situations, the effects of remeasurements should not be included in the returns that an entity has generated on its economic resources. Accordingly, the ASBJ thinks that such effects of remeasurements should not be included in profit or loss.

42. The ASBJ's view described above is similar to the characteristics of "transitory remeasurements" proposed in paragraphs 8.88 and 8.89 of the DP¹¹. In the DP, transitory remeasurements and bridging items are independently different classifications, but the ASBJ thinks that it is the characteristics of transitory remeasurements that are the factors which necessitate the use of OCI as the linkage factor.
43. The ASBJ's view that OCI should be associated with risk exposures is consistent with the findings of the research on the use of OCI, which was carried out by the ASBJ and presented to the IASB at the February 2013 IASB Board meeting. The findings of the research indicated that the ratios of OCI to profit or loss (or the ratios of accumulated OCI to total equity) were high when the time horizon was long and macroeconomic factors fluctuated significantly.

¹¹ Paragraph 8.88 of the DP states that the IASB should consider recognising items of income and expense in OCI if they have all of the following characteristics:

- (a) the asset will be realised, or the liability will be settled, over the long-term;
- (b) the current period remeasurement is likely to reverse fully, or significantly change (in either direction), over the holding period of the asset or the liability; and
- (c) recognising the current period remeasurement fully or partly in OCI enhances the relevance and understandability of profit or loss as the primary indicator of the return that the entity has made on its economic resources.

Chapter 4: Recycling

44. Based on the definitions of comprehensive income, profit or loss and OCI suggested in this paper (Please refer to paragraphs 5 and 7 of this paper), the ASBJ discusses how and when items should be recycled.

45. Paragraph 7 of IAS 1 *Presentation of Financial Statements* defines reclassification adjustments (recycling) as follows:

Reclassification adjustments are amounts reclassified to profit or loss in the current period that were recognised in other comprehensive income in the current or previous periods.

46. The ASBJ thinks that OCI is used because although both comprehensive income and profit or loss figures are determined based on the changes in net assets, different measurement bases are used for certain assets and liabilities in determining these figures. In cases where the measurement bases are different from the perspectives of reporting an entity's *financial position* and *financial performance*, the ASBJ thinks that recycling occurs when:

- (a) related assets or liabilities are derecognised;
- (b) impairment losses are recognised for related assets; or
- (c) a natural reverse occurs with the passage of time.

47. When assets or liabilities are derecognised, the carrying amounts of the assets or liabilities would be reduced to zero. If different measurements are used from the perspectives of reporting an entity's *financial position* and *financial performance*, comprehensive income will vary from profit or loss by the amount equal to the difference between the amounts those assets or liabilities had previously been recognised at when such assets or liabilities are derecognised. As a result, recycling would be achieved automatically.

48. An example of the situation referred to in paragraph 46(b) of this paper would be when impairment losses are recognised for available-for-sale securities under IAS 39 *Financial Instruments: Recognition and Measurement*, where the different measurement bases are used from the perspectives of reporting an entity's *financial position* and *financial performance*. When impairment losses are recognised, both measurements would be reduced to fair value and thus comprehensive income would differ from profit or loss by the amount equal to the difference between the amounts the assets had previously been recognised at. As a result, recycling would be achieved automatically.
49. An example of the situation referred to in paragraph 46(c) of this paper would be OCI items under the Revised Exposure Draft (ED/2013/7) *Insurance Contracts*. The difference between the effects of discounting cash flows at a current rate at the end of the period, and the effects of discounting those same cash flows at the rate that applied at initial recognition would be recognised in other comprehensive income and would unwind automatically over time.
50. Under all of the situations referred to in paragraph 46 of this paper, recycling would be achieved automatically as a mechanism and, therefore, non-recycling items would not exist. Accordingly, the difference between comprehensive income and profit or loss is essentially a timing difference and conceptually the accumulated amount of profit or loss for all accounting periods should equal the accumulated amount of comprehensive income for all accounting periods.

Supplementary considerations: Additional commentary on how to determine the measurement bases

51. In Chapter 3 of this paper, the ASBJ discusses using two different measurement bases for the same item. In the following paragraphs, the ASBJ will explore when two different measurement bases should be used for the same item, discussing separately assets and liabilities.

Assets

52. Paragraph 6.73 of the DP explains that the IASB's preliminary view is that the measurement used for a particular asset should depend on how the asset contributes to future cash flows. Four general ways in which an asset contributes to future cash flows are explained below:

How the asset contributes to future cash flows	Likely measurement basis
Using it in business operations to generate revenues or income	Cost-based measurement
Selling it	Current market price
Holding it for collection according to terms	Cost-based measurement (but not for derivatives)
Charging others for rights to use it	Cost-based measurement or current market price

53. The ASBJ agrees with the view that the measurement basis used for a particular asset should depend on how the asset contributes to future cash flows. For each category, the ASBJ discusses the measurement bases that are relevant from the perspective of reporting an entity's *financial position* and the measurement bases that are relevant from the perspective of reporting an entity's *financial performance*.

Using an asset in business operations to generate revenues or income

54. The ASBJ thinks that cost-based measurement is relevant from the perspectives of reporting both an entity's *financial position* and *financial performance* because the changes in current market prices do not have any relationship to the future cash flows that will be generated from using the assets in business activities.
55. It can be argued that management always has the option to sell the assets or continue to use them in order to generate revenues or income in business operations and whether assets should be measured at current market prices in order to report the basis for the management's decisions to continue to use the assets should be considered from the perspective of reporting an entity's *financial position*. Although the current market price or cash-based measurement may be relevant from the perspective of reporting an entity's *financial position*, it is difficult to uniquely determine the current market price or cash-flow-based measurement because such measurement can vary depending on the other assets to be combined with when an asset is used together with other assets to generate cash flows. Accordingly, cost-based measurements would be the only feasible option for these types of assets.

Selling an asset

56. The ASBJ thinks that the current market price is relevant for an asset held to be sold, provided that the assets classified in this category are limited to those investments held for trading.
57. In this case, the ASBJ thinks that the current market price is relevant from the perspective of reporting an entity's *financial position* because the entity can generate cash flows that are equivalent to the current market price. Furthermore, the ASBJ thinks that the current market price is relevant from the perspective of reporting an entity's *financial performance* because the outcomes of the entity's

business activities are deemed irreversible and the changes between cost and current market price represent the outcomes of the investment in light of the purpose of the transactions.

58. In the ASBJ's view, derivatives except for those used in cash flow hedges¹² should be classified in this category. Accordingly, the current market price is relevant from the perspectives of both reporting an entity's *financial position* and *financial performance* for such items.

Holding an asset for collection according to terms

59. The ASBJ agrees with the proposals in the DP that cost-based interest income, along with bad debt expenses as estimated by management, is likely to provide relevant information. The ASBJ thinks that this is applicable from the perspectives of reporting both an entity's *financial position* and *financial performance*.
60. However, there may be cases where management intends either (a) to hold an asset for collection according to terms or (b) to sell the asset where an entity has the practical ability to do so. In this case, the ASBJ thinks that the current market price is relevant from the perspective of reporting an entity's *financial position* because the entity can generate cash flows equivalent to the current market price if it wishes to do so. From the perspective of reporting an entity's *financial performance*, cost-based measurement is relevant because the uncertainty regarding whether the cash flows will actually occur at current market price has not been reduced to the point where the outcomes are irreversible or deemed irreversible.

¹² Paragraphs 77 and 78 of this paper discuss the treatment of cash flow hedges.

Charging others for rights to use an asset

61. The ASBJ thinks that cost-based measurement is relevant from the perspective of reporting an entity's *financial position* when management primarily intends to earn rental income. This is because the current market price does not have any relationship with future cash flows that will be generated from charging others for rights to use the assets.
62. However, there may be cases where management intends either (a) to earn rental income or (b) to sell the asset where an entity has the practical ability to do so. In this case, the ASBJ thinks that the current market price is relevant from the perspective of reporting an entity's *financial position* because the entity can generate cash flows equivalent to the current market price if it wishes to do so. From the perspective of reporting an entity's *financial performance*, the ASBJ thinks that cost-based measurement is relevant because the uncertainty regarding the outcomes of the entity's business activities is not reduced to the point where the outcomes are irreversible or deemed irreversible when the entity bears the risk relating to any fluctuations in the residual value of the assets.

Assets: Summary

63. The following table summarises the ASBJ's views discussed in paragraphs 52 through 62 of this paper.¹³

¹³ Although it is not included in the table, it is necessary to determine whether impairment has occurred in order to ensure that its assets are carried at no more than their recoverable amount. When impairment losses are recognised, current market price or cash-flow-based measurement will be used from the perspectives of reporting an entity's *financial position* and *financial performance*.

How the asset contributes to future cash flows	Likely measurement basis	
	From the perspective of reporting an entity's <i>financial position</i>	From the perspective of reporting an entity's <i>financial performance</i>
Using an asset in business operations to generate revenues or income	Cost-based measurement	Cost-based measurement
Selling an asset (held for trading)	Current market price	Current market price
Holding an asset for collection according to terms	Cost-based measurement	Cost-based measurement
Either holding an asset for collection according to terms or selling it	Current market price	Cost-based measurement
Charging others for rights to use an asset	Cost-based measurement	Cost-based measurement
Either charging others for rights to use an asset or selling it	Current market price	Cost-based measurement

Liabilities

64. Regarding the appropriate measurement bases for liabilities, the DP states the following:

- (a) Paragraph 6.97 of the DP states that the nature of a liability and the way it will be settled are important in identifying the appropriate measurement for that liability. Paragraph 6.98 goes on to say that liabilities fall into two groups – those with stated terms and those without stated terms.

- (b) Paragraph 6.99 of the DP states that cash-flow-based measurement may be the only possible option for liabilities without stated terms.
- (c) Paragraph 6.100 of the DP states that for some types of contractual liabilities that have stated terms but highly uncertain settlement amounts that have not yet been determined (for example, insurance contracts and post-employment benefits), a cash-flow-based measurement may also provide the most relevant information.
- (d) Paragraph 6.101 of the DP states that liabilities with stated terms are those that come from contracts, statutes or regulations that state either a settlement amount or the method for determining the settlement amount and there are three ways in which an entity might settle a liability with stated terms.

65. The following table summarises the proposals in the DP.

How the liability is settled or fulfilled	Likely measurement basis
Liabilities without stated terms	Cash-flow-based measurement
Liabilities which have stated terms but highly uncertain settlement amounts that have not yet been determined	Cash-flow-based measurement
Paying cash or delivering other assets according to the stated terms	Cost-based measurement (but not for derivatives)
Being released by the creditor on transferring the obligation to another party	Current market price
Performing services or paying others to perform services	Cost-based measurement

66. The ASBJ generally agrees with the proposals described above. The ASBJ thinks that the current market price would not be relevant unless the liability can

be transferred because the current market price has no relationship with actual cash flows. Therefore, for liabilities other than derivatives¹⁴, a cost-based measurement or cash-flow-based measurement should be used, depending on the terms of the liability.

67. The ASBJ thinks that although a single measurement basis should be used for most liabilities, two different measurement bases can be used for liabilities which have stated terms but highly uncertain settlement amounts that have not yet been determined¹⁵.

Liabilities which have stated terms but highly uncertain settlement amounts that have not yet been determined

68. When a liability has stated terms but a highly uncertain settlement amount that has not yet been determined is remeasured by using a cash-flow-based measurement, it may be relevant to use inputs that are updated at the reporting date from the perspective of reporting an entity's *financial position*. For example, in the case of remeasuring insurance liabilities, using the discount rate at the reporting date may more faithfully represent insurance liabilities than using the discount rate at initial recognition.
69. However, from the perspective of reporting an entity's *financial performance*, it may not be relevant to recognise gains or losses using inputs that are updated at the reporting date. For example, in the case of remeasuring insurance liabilities, recognising gains or losses due to changes in discount rates may not be relevant because the effects of discounting do not have any relationship with actual cash flows. In this case, using the inputs applied at initial recognition can be relevant.

¹⁴ Measurement of derivatives is not considered in this paper.

¹⁵ In addition, paragraphs 84 through 87 of this paper discuss the change in fair value due to the issuer's own credit risk relating to financial liabilities designated at fair value through profit or loss, where two measurements should be used for the same item.

70. Based on the discussions above, two different measurement bases can be used when remeasuring liabilities which have stated terms but highly uncertain settlement amounts that have not yet been determined due to different inputs.

Liabilities: Summary

71. The table below summarises the ASBJ's views that are discussed in paragraphs 64 through 70 of this paper.

How the liability is settled or fulfilled		Likely measurement basis	
		From the perspective of reporting an entity's <i>financial position</i>	From the perspective of reporting an entity's <i>financial performance</i>
Liabilities without stated terms		Cash-flow-based measurement	Cash-flow-based measurement
Liabilities which have stated terms but highly uncertain settlement amounts that have not yet been determined	In principle	Cash-flow-based measurement	Cash-flow-based measurement
	Exception	Cash-flow-based measurement (using inputs updated at the reporting date)	Cash-flow-based measurement (using inputs at initial recognition)
Paying cash or delivering other assets according to the stated terms		Cost-based measurement (but not for derivatives)	Cost-based measurement (but not for derivatives)
Being released by the creditor on transferring the obligation to another party		Current market price	Current market price
Performing services or paying others to perform services		Cost-based measurement	Cost-based measurement

Supplementary considerations: Analysis of OCI items under existing IFRSs

72. In paragraph 5 of this paper, the ASBJ suggested definitions of comprehensive income and profit or loss. Following on from these definitions, in paragraph 7 of this paper, the ASBJ suggested defining OCI as “the linkage factor” that is used when the measurements that are relevant from the perspective of reporting an entity’s *financial position* differ from the measurements that are relevant from the perspective of reporting an entity’s *financial performance*.
73. Because justification of existing accounting standards is not its objective, the Conceptual Framework under review does not necessarily need to be consistent with existing accounting standards. However, the ASBJ believes that OCI items under existing IFRSs can generally be explained as the linkage factor that links comprehensive income and profit or loss. The linkage factor concept is similar to the “bridging items” concept in the DP. Accordingly, the ASBJ will focus its discussions on the OCI items that are proposed as “mismatched remeasurements” and “transitory remeasurements” in the DP.

Net investment in foreign operations

74. The DP classifies the exchange differences relating to foreign operations as mismatched remeasurements. However, the ASBJ thinks that this OCI item can be explained as a linkage factor.
75. IAS 21 *The Effects of Changes in Foreign Exchange Rates* requires that assets and liabilities for each statement of financial position presented be translated at the closing rate at the date of that statement of financial position to depict an entity’s *financial position*. Additionally, the standard requires that income and expenses for each statement presenting profit or loss and other comprehensive income be translated at exchange rates at the dates of the transactions to depict an entity’s *financial performance*.

76. Although the DP does not explicitly discuss foreign currency translation, the ASBJ thinks that the relationship between foreign currency translation and measurement should be clarified. Regardless of how the relationship will be clarified, considering the figures after translation, the ASBJ thinks that using two sets of different exchange rates (that is, the rates that are used to translate assets and liabilities in the statement of financial position and the rates that are used to translate income and expenses in the statement of profit or loss and other comprehensive income) can be treated in the same way as using two different measurement bases. In this case, the ASBJ thinks that the exchange differences relating to foreign operations can be explained as a linkage factor.

Cash flow hedges

77. The DP classifies the OCI item arising from cash flow hedges as mismatched remeasurements. However, the ASBJ thinks that, in general, the OCI item arising from cash flow hedges can be explained as a linkage factor¹⁶.

78. From the perspective of reporting an entity's *financial position*, the current market price is relevant in order to help users assess the prospects of future net cash flows to an entity. On the other hand, from the perspective of reporting an entity's *financial performance*, the current market price is not relevant and, instead, the hedging instrument should continue to be measured at zero¹⁷ until the hedged transactions occur. When the hedged transactions occur, the hedging instrument should be measured at the amount that effectively offsets gains or losses of the associated hedged item. The ASBJ thinks that the difference between the two measurements should be recognised in OCI as a linkage factor.

¹⁶ The ASBJ acknowledges that, in the case of a hedge of a forecasted transaction which subsequently results in the recognition of a non-financial asset or non-financial liability under paragraph 98 (a) of IAS 39 *Financial Instruments: Recognition and Measurement*, accumulated OCI balances would remain even after the hedging instruments are derecognised. In such cases, the ASBJ thinks that two different measurement bases are not used and, accordingly, such cash flow hedges cannot be explained as a linkage factor.

¹⁷ This assumes that the entity initially recognises the hedging instrument at nil.

Revaluations of property, plant and equipment and intangible assets

79. The ASBJ thinks that taking into account the objectives of the revaluation model, the use of OCI should be reconsidered for revaluations of property, plant and equipment and intangible assets. Adjusting the gains and losses as an equity component, not as an OCI item, could be appropriate if the objective of the revaluation model was to address fluctuations of prices based on the concept of capital maintenance. The ASBJ will not explore this issue further because the discussion of capital maintenance is beyond the scope of this paper. Nevertheless, the ASBJ thinks that this item should not be discussed under the premise that it should be accounted for as an OCI item.

Pensions

80. Paragraphs 8.72 through 8.74 of the DP discuss the treatment of pensions. The DP does not classify the remeasurement of a net defined benefit pension asset or liability in accordance with IAS 19 *Employee Benefits* as a bridging item nor as a mismatched remeasurement. The DP explains that this item cannot be classified as a bridging item due to the issues relating to resetting discount rates and recycling. Under Approach 2B of the DP, this item is classified as a transitory remeasurement.

81. The ASBJ thinks that a thorough analysis of the accounting for defined benefit plans is beyond the purpose of this paper. Accordingly, the ASBJ will focus on the recycling of the remeasurements of defined benefit assets or liabilities without discussing other accounting treatments.

82. Agenda Paper 10H (a) for the April 2013 IASB Board meeting discussed the recycling of remeasurements of defined benefit assets or liabilities. That paper considered several alternatives to recycle the remeasurements of defined benefit assets or liabilities. Alternatives in that paper included:

- (a) recycling would occur at the termination of each individual contract; and
 - (b) recycling would occur when the scheme itself is disposed of or closed.
83. Although it may be difficult to determine an appropriate recycling model, the ASBJ thinks that an acceptable recycling model can be developed and thus remeasurements of defined benefit assets or liabilities can be explained as a linkage factor.

Financial liabilities designated at fair value through profit or loss

84. Changes in the fair value of financial liabilities designated at fair value through profit or loss, that are due to the issuer's own credit risk, are classified by the DP as possibly mismatched remeasurements under Approach 2A of the DP and as transitory remeasurements under Approach 2B of the DP.
85. Paragraphs 6.128 through 6.130 of the DP discuss the entity's own credit risk. These paragraphs discuss whether gains should be recognised when a liability is discounted at a higher rate either because an entity's credit standing is deteriorating or because there has been an increase in the market price for bearing the risk of changes in the probability of default.
86. The ASBJ thinks that this item can be explained as a linkage factor that is used when the measurements that are relevant from the perspective of reporting an entity's *financial position* differ from the measurements that are relevant from the perspective of reporting an entity's *financial performance*.
87. When financial liabilities are measured at fair value, such fair value would reflect the entity's own credit. The ASBJ thinks that reflecting all risks is relevant from the perspective of reporting an entity's *financial position*. However, it may not be relevant from the perspective of reporting an entity's

financial performance because it is unreasonable to recognise gains due to the deteriorations of the entity's credit standing. Accordingly, two different measurement bases should be used for this item and, therefore, OCI would be used as a linkage factor.

Designated investments in equity instruments

88. The DP states that designated investments in equity instruments are unlikely to be classified as either bridging items or mismatched remeasurements unless an operational impairment model can be developed under Approach 2A. Under Approach 2B, this item is classified as a transitory remeasurement.
89. The ASBJ thinks that different accounting treatments should be applied depending on the purpose of the equity investments.
90. As discussed in paragraphs 56 through 58 of this paper, for equity instruments held for trading that will contribute to future cash flows by “selling an asset,” the ASBJ thinks that the current market price is relevant from the perspectives of reporting both an entity's *financial position* and *financial performance*. Accordingly, a single measurement basis should be used and thus OCI would not be used.
91. Table 8.2 of the DP states that fair value is generally regarded as the most relevant measure of performance for equity instruments, except, arguably, for some strategic investments. Although it may be difficult to define strategic investments, the ASBJ thinks that the scope of such type of investments can be identified¹⁸.

¹⁸ The ASBJ does not think that all investments in equity instruments other than those held for trading may qualify as strategic investments. For example, it may be useful to identify the scope of strategic investments considering the following factors:

- (a) The objective of the investment is not to gain capital appreciation, but to retain or strengthen business ties with investees.
- (b) The performance of the investment is not evaluated primarily based on changes in its fair value.
- (c) Normally, the holding period of the investment is long.

92. If a strategic investment has the objective of retaining or strengthening business ties with the investee, the ASBJ thinks that, theoretically, a cost-based measurement is relevant from the perspectives of reporting both an entity's *financial position* and *financial performance* because the investments can generate cash flows through the enhanced relationships with investees together with other assets used in the entity's business activities. However, the current market price may be relevant from the perspective of reporting an entity's *financial position* considering the fact that these investments are financial instruments. In this case, OCI would be used as a linkage factor.

Appendix A: Relationship between OCI items under existing IFRSs and risk exposures

IFRS or proposed IFRS	Recognised asset or liability	OCI item	Type of risk exposures	Related macroeconomic factors
IFRS 9 2012 ED	Financial assets measured at fair value through OCI	Changes in fair value	Market risk	Interest rates
Insurance Contracts 2013 ED	Insurance contracts	Changes in discount rate	Market risk	Interest rates
IAS 16, IAS 38, IFRS 6	Property, plant and equipment, intangible assets and exploration and evaluation assets	Revaluation gain or reversals	Market risk	Prices of property, plant and equipment etc.
IAS 19	Pensions - net defined benefit assets or liabilities	Remeasurement	Market risk	Stock prices, interest rates
IAS 21	Net investment in foreign operations (and hedges)	Exchange differences	Market risk	Exchange rates
IFRS 9 2010 ED	Cash flow hedging instruments	Effective portion of change in fair value	Market risk	Exchange rates, interest rates
IFRS 9	Financial liabilities designated at fair value through profit or loss	Change in fair value due to issuer's own credit risk	Credit risk	N/A
IFRS 9	Designated investments in equity instruments	Change in fair value	Market risk	Stock prices

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